

Retiree News & NOTES



STATE RETIREMENT
and PENSION SYSTEM
of MARYLAND

JANUARY 2007

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A Newsletter for Retirees from the State Retirement & Pension System of Maryland

How to change your tax withholding

IF YOUR FILING STATUS, EXEMPTIONS OR EXEMPT STATUS HAS CHANGED, you need to file a new *Federal and Maryland State Tax Withholding Request* (Form 766).

Form 766 revokes all prior federal and state tax withholding elections. For example, if you previously requested federal and state tax withholdings and now submit a new request indicating only state tax, your prior federal tax withholdings will be cancelled. You must fill out **both** sections of the form *even if you wish to update only one portion of your withholdings*.

Under current federal law, you cannot designate only a specific dollar amount to be withheld for federal tax. However, you can designate an additional amount to be withheld on Part I, line 3 of Form 766, provided you indicated your marital status and number of allowances on line 2 of the form.

Form 766 can be downloaded from the State Retirement Agency Web site at www.sra.state.md.us. Click on **Retirees** and then **Forms** to access Form 766. You can also request this form by calling a retirement benefits counselor at 410-625-5555 or toll free 1-800-492-5909.

State Retirement Pick-up and your taxes

FOR ELIGIBLE RETIREES, Block 15 of the 1099-R form contains the amount of your tax deferred contributions made under the State Retirement Pick-up Program. This figure is important for Maryland State income tax preparation.

The State Pick-up Program is concerned with the employee pension plan contributions made while working. It provides for the deferral of federal taxes when the contributions are made, but makes them taxable when received in the pension. Since this program only defers federal taxes at the time the contributions are made, state income taxes were deducted. The consequence in retirement is that the state income tax is deferred until the pick-up contributions are recovered.

While most members participated in the pick-up program, your participation was determined by whether your employer elected to participate and by whether your pension plan required you to make an employee contribution.

FEDERAL TAXES

Since eligible members did not pay any federal taxes on their pick-up contributions during employment, taxes must be paid during retirement. You do not need to make any special entries on your federal tax form — the Retirement Agency has included your pick-up contributions when computing the taxable amount of your pension for federal tax purposes.

MARYLAND STATE TAXES

You have already paid Maryland State taxes on the pick-up contributions listed on your 1099-R. To avoid paying taxes twice, you must subtract the pick-up amount from your federal adjusted gross income shown on page 1 of your Maryland tax return (Form 502) as follows:

Enter your pick-up amount on line 14, entering code letter "r." This serves as a subtraction from your income which will reduce your taxable net income on line 22 (Form 502).

The subtraction is limited to the amount of pick-up contribution stated on the 1099-R or the taxable pension, whichever is less. The remainder of the pick-up amount is carried over to next year's taxes. When the pick-up amount reaches zero, "EP used" will be printed in the pick-up block on your 1099-R. This usually occurs within a few years after the date of retirement.

ATTENTION 2006 RETIREES

For members who retired in 2006, the W-2 form you receive from your former employer will show 1) your annual wages earned prior to retirement and 2) any State pick-up contributions made in 2006. This amount serves as an addition to State income for 2006. Enter this figure on line 3 of your Maryland tax return (Form 502).

System achieves third straight year

FOR THE THIRD CONSECUTIVE YEAR, the State Retirement and Pension System of Maryland posted strong investment returns. The total return for the System was 10.4% for the fiscal year ending June 30, 2006.

This is a summary of the System's activities for the year ending June 30, 2006. For more detailed information, the System's comprehensive annual financial report is available online at www.sra.state.md.us.

SYSTEM FINANCES

The System is responsible for properly administering the retirement, disability and death benefits for its members and retirees. The System's overall funding objective is to accumulate sufficient assets over time to meet these long-term benefit obligations as they become due.

Revenues

During fiscal year 2006, investment earnings were \$3.2 billion, while revenues from employer and member contributions were \$721 million and \$215 million, respectively. For fiscal year 2006, member contribution

REVENUES

Employer Contributions	
2006	\$721 million
2005	\$670 million
Employee Contributions	
2006	\$215 million
2005	\$209 million
Net Investment Income	
2006	\$3.2 billion
2005	\$2.8 billion

The Agency will continue to search for the optimal investment tradeoffs that will provide an attractive return expectation while maintaining acceptable levels of investment risk.

rates remained unchanged, while employer rates varied depending on the System.

Expenses

Retirement allowances paid to retirees and beneficiaries totaled \$1.8 billion in fiscal year 2006. An additional \$16.4 million was paid to members and withdrawing employers as a result of employment terminations and withdrawals from the System. Expenses for management of the investment portfolio and

administration of the System were \$144.8 million and \$18.6 million, respectively.

Funded Status

As of June 30, 2006, the System's actuarial accrued liability was \$43.2 billion. With the actuarial value of assets accumulated to pay the liability at \$35.8 billion, the System now stands at 82.78% funded. Because returns are smoothed over a five year period for actuarial valuation purposes, coupled with benefit enhancements enacted in 2006, the System experienced a decrease in its funded ratio in fiscal year 2006. The System, however, remains financially strong and on schedule with regard to its long-term funding goals.

INVESTMENTS

The System continued to experience strong investment gains during fiscal year 2006 with a return of 10.4%.

EXPENSES

Benefit Payments	
2006	\$1.8 billion
2005	\$1.7 billion
Refunds	
2006	\$16 million
2005	\$19 million

of investment growth

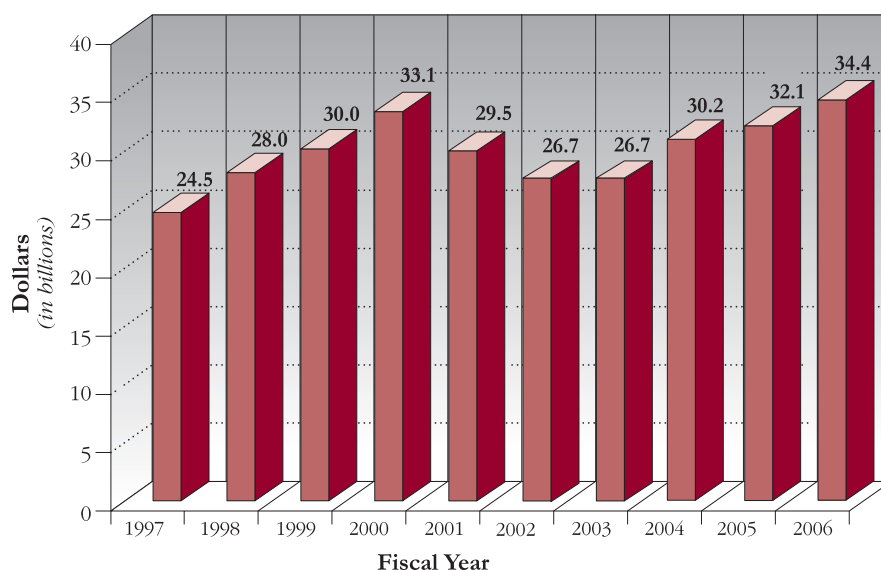
Annualized returns for the three, five, and 10-year periods ending June 30 were 12.0%, 6.0% and 7.3%, respectively. The market value of System assets increased from \$32.1 billion on June 30, 2005 to \$34.4 billion on June 30, 2006. The System's equity investments returned 14.4%, with domestic equities returning 9.0% and international equities returning 28.2%. The System's fixed income investments returned -0.2%, and real estate returned 23.8%.

Looking forward to fiscal year 2007, the Agency will continue to search for the optimal investment tradeoffs that will provide an attractive return expectation while maintaining acceptable levels of investment risk.

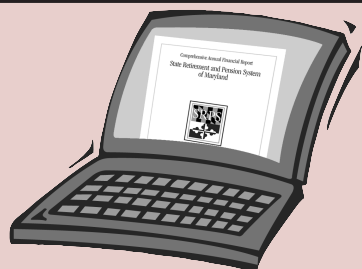
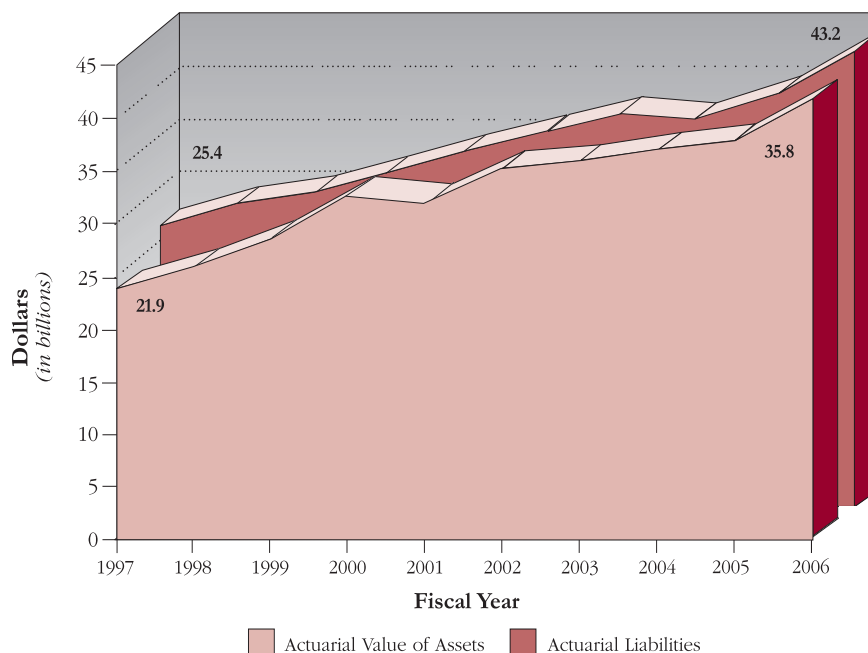
MEMBERSHIP

The System's rolls included 191,273 active members as of June 30, 2006, an increase of 3,223 members from the previous year. The System also served 103,831 retirees and beneficiaries at the end of fiscal year 2006, an increase of 3,635 over the previous year. During fiscal year 2006, the number of former members who are eligible for a future benefit (i.e., vested members) increased by 1,646 to a total of 49,310.

TEN-YEAR GROWTH OF INVESTMENT PORTFOLIO



TEN-YEAR HISTORY OF FUNDING PROGRESS



FOR MORE INFORMATION ...

The System's Comprehensive Annual Financial Report for fiscal year 2006 is available in its entirety online. Visit the State Retirement Agency Web site at www.sra.state.md.us to access a printable version of the report.

Understanding your 1099-R

PERSONALIZED COPIES OF INTERNAL REVENUE SERVICE FORM 1099-R will

be distributed to all State Retirement and Pension System retirees by the end of January, 2007. The forms provide each retiree with detailed information on his or her pension income for the previous year. Most retirees receive only one 1099-R each year. However, members who retired in 2006 will receive a separate form 1099-R for any additional refunds they received, such as a refund of State pick-up contributions or a refund of voluntary annuity contributions.

How to Read Your 1099-R

BLOCK 1.

(Gross Distribution)

This is the total amount of pension benefits paid to you by the State Retirement Agency during the 2006 calendar year.

BLOCK 2A.

(Taxable Amount)

This is the taxable amount of your pension. Depending on your retirement date and whether you contributed to your plan, you may not be taxed on the total amount of benefits paid to you. If this is the case, the amount shown in this block will differ from the amount in Block 1.

BLOCK 2B.

(Taxable Amount Not Determined)

This block applies only to disability retirees who retired prior to January 1, 1995. These individuals should consult IRS Publication 575 before preparing their tax returns.

BLOCK 4.

(Federal Income Tax Withheld)

This block shows any federal income tax deducted from your monthly retirement checks. To change the amount of federal income tax being

withheld, complete a tax withholding request form (Form 766), available through the State Retirement Agency.

BLOCK 5.

(Employee Contributions)

This is the amount of your contributions that were recovered, tax free, during 2006. This figure is the difference between the amounts in Blocks 1 and 2a. The dollar figure in this box does NOT represent the amount of any health insurance premiums withheld from your benefit payment.

BLOCK 7.

(Distribution Code(s))

IRS codes are explained on the back of the 1099-R form.

BLOCK 9B.

(Total Employee Contributions)

For retirees who received their first benefit payments in 2006, this block contains the value of any contributions made during employment that can be recovered tax-free. Only

members who retired in 2006 and made pension contributions will see a value in this block. For members who retired prior to 2006, a zero will be printed in the block.

BLOCK 10.

(State Income Tax Withheld)

Any Maryland State income tax deducted from your monthly checks is shown in this block. To change the amount being withheld, complete a tax withholding request form (Form 766).

BLOCK 15.

(Pick-Up Contributions)

This figure applies to members whose employers participated in the State Pick-up Program. For an explanation of pick-up contributions, see "State Retirement Pick-up and your taxes" on page 1.

DUPLICATE 1099-R

To request a duplicate copy of your 1099-R form, please call the State Retirement Agency at 410-625-5555 or 1-800-492-5909.

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